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Supreme Court of the United States

October Term, 1927

No. 554 / 16

ELIZABETH C. TAFT, *Petitioner,*

vs.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF FOR PETITIONER

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The pith of the Respondent's argument to support the constitutionality of this statute may be briefly summarized as follows:

(1) A gift is in its intrinsic nature "income" and is therefore constitutionally taxable to the donee in whole or in part when received.

(2) Congress can constitutionally postpone levying the tax until conversion at a later date, that is, until such time as the corpus of the gift is sold or disposed of by the donee.

With these premises we cannot agree. The burden of the Respondent's argument is that the corpus of a gift is income because, (a) "in the ordinary sense of the word and as it is used in common speech, the word 'gift' conveys the meaning of true income to the donee" (page 11,

Respondent's brief); and (b) it is to be inferred from the language of the Federal and several state income tax statutes which exempts gifts from taxation, that a gift is in its intrinsic nature, income.

Do these statements stand the test of analysis? Would it, in the words of the Respondent's brief (page 11), "surprise the man in the street, for whom the tax laws are intended, to be told that if he received a gift under the circumstances of these cases he would not have made a gain nor be in receipt of income." But would it not cause greater surprise in a bride who receives a wedding gift of $200,000 from her father to provide her with some separate means and income to be told that such gift is a part of her income; or would it not surprise a business executive who is unexpectedly given a bonus at New Years to be warned that he must regard the amounts, however large, as a part of his income; or can it be said that a baseball hero who is presented with an automobile at the end of the season by his admirers, must regard the car as a part of his income? More striking still, is the case of one who receives a legacy of personal property or a devise of land. Can it be said that the man in the street who receives it would regard it as a part of his income? Indeed, we venture to say that such a person would be very much surprised if he were to be informed that the legacy or the devise *was* a part of his income. Yet that a gift and a legacy were regarded in the same category by Congress seems very clear from the fact that they are grouped together in the very same exemption clause in the income tax acts, not only in the Federal Income Tax Act, Section 213 (b) (3), (page 5 our main brief), but also in the various state acts. We suggest, therefore, that it is certainly too broad a generalization to conclude

that all gifts—especially casual gifts of the nature of the one here under consideration—are in common speech and understanding regarded as income to the recipient. The Respondent's conclusions are scarcely supported by the facts.

The Respondent next seeks to draw from the exemption clauses in the Federal and state income tax statutes the inference that Congress and the Legislatures regard gifts as intrinsically income. The argument is far from conclusive. For instance, the Respondent quotes from Section 4 of the Revenue Act of 1916 as amended (page 13, Respondent's brief), as follows:

> "SEC. 4. The following *income* shall be exempt from the provisions of this title: * * * the value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included as income); * * * (Italics ours.)"

In the first place that Congress has referred to something as "income" does not make it so. Respondent fails to mention the language found in all of the later acts covering the same subject which provides as follows:

> "The term 'gross income' does not include the following *items* which shall be exempt from taxation under this title * * *.
>
> (3) The value of property acquired by *gift*, bequest, devise or inheritance * * *." (Italics ours.)

(Section 213, (b), (3), Revenue Act, 1921, 1924, 1926.)

Obviously, the purpose of these clauses was to see to it that a gift should not be taxed to the donee when received. That accomplished, we do not believe that it is

to be presumed that Congress gave any deep and laborious thought to the question whether a gift is intrinsically income. Certainly one should not rely on the vagaries of the wording of our many recent revenue laws to draw such an important inference unless there is a legislative history to prove that the language was adopted with such a purpose and there appears to be no such in respect to these clauses.

It seems to us that a pertinent question in this connection is this. If Congress was convinced that a gift is intrinsically income, why did it resort in the Revenue Act of June 2, 1924, Sections 319-324, to an excise tax upon gifts *inter vivos* as a source of revenue? It would have been far simpler to have omitted the word "gift" from Section 213 (b) (3) and levied an income tax upon them and unquestionably the revenue derived would have been much greater.

In this connection, Respondent quotes at page 12 of his brief, from *Rice* v. *Eisner,* 16 F. (2) 358, as follows:

> "The exemption in all the statutes of the corpus of gifts and bequests shows that in the minds of those who drew the acts it was thought open to question whether even this might not be considered income."

This proves too much. It admits of doubt, and in all cases of doubt the statute is to be resolved in favor of a taxpayer.

> *Gould* v. *Gould,* 245 U. S. 151;
> *Smietanka* v. *First Trust and Savings Bank,* 257 U. S. 602.

The Respondent admits his inability to find any decision holding that the corpus of a gift is intrinsically

income but trusts to general inferences from common usage and from the wording of the statutes. As against this we offer the following rulings and cases under the income tax laws which are certainly entitled to weight. Under the Income Tax Act of 1862 the Commissioner of Internal Revenue ruled as follows:

> "Gifts of money, when clearly not in the nature of payment for services rendered, or for other valuable consideration, are not liable to taxation as income" (7 Internal Revenue Record 59).

In *U. S.* v. *Oregon-Washington R. & Nav. Co.*, 251 Fed. 211, a creditor forgave indebtedness of approximately six million dollars. The Court held that this did not constitute income to the debtor. The effect of the transaction was exactly the same as if the creditor had handed to the debtor as a gift the amount of the indebtedness and said, "Now pay me what you owe me." It was clearly a gift. See also *Edwards* v. *Cuba R. R. Co.*, 268 U. S. 628. The weight of opinion as thus far expressed is certainly on the side of the argument that the corpus of a gift is not intrinsically income.

Finally, on this point we again invite your attention to the definition of income (page 7, our main brief) adopted and repeatedly followed by this Court. How can the corpus of a gift be gain derived *from* capital, *from* labor, or from *both* combined, of the donee, or from a conversion of capital assets? There is no such conversion.

We submit that the corpus of a casual gift of this sort is not intrinsically "income" to the donee within the meaning of the Sixteenth Amendment of the Federal Constitution. It is, therefore, a capital transaction.

There is one more argument of the Respondent to which we wish to invite attention. On page 24 of the Respondent's brief, he quotes from the case of *U. S.* v. *Phellis,* 257 U. S. 156, as follows:

> "In buying at a price which reflected the accumulated profits, he of course acquired as a part of the valuable rights purchased the prospect of a dividend from the accumulations—bought 'dividend on,' as the phrase goes—and necessarily took subject to the burden of the income tax proper to be assessed against him by reason of the dividend if and when made. He simply stepped into the shoes, in this as in other respects, of the stockholder whose shares he acquired, and presumably the prospect of a dividend influenced the price paid, and was discounted by the prospect of an income tax to be paid thereon."

The above language was used by this Court in response to the argument that the tax in that case was a tax on capital. The Respondent draws from this language the conclusion that the donee in the same way steps into the shoes of the donor. The analogy is far from perfect. When an investor purchases, presumably he looks into all of the surrounding facts concerning the securities that he proposes to buy and is on notice. This, however, is not true of the donee of a casual gift. To use an expressive colloquialism, "one does not look into the mouth of a gift horse." The donee of the casual gift makes no opportunity to search into the past history and facts surrounding the property which is the subject of a gift. That generally is of no concern to him and he would be embarrassed by inquiring about it. He may step into the shoes of the donor in some respects, but he certainly

does not generally do so with notice of the past facts concerning the property as does the investor and he should not be charged with such notice.

Respectfully submitted,

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